DOW THEORY LETTERS INC.

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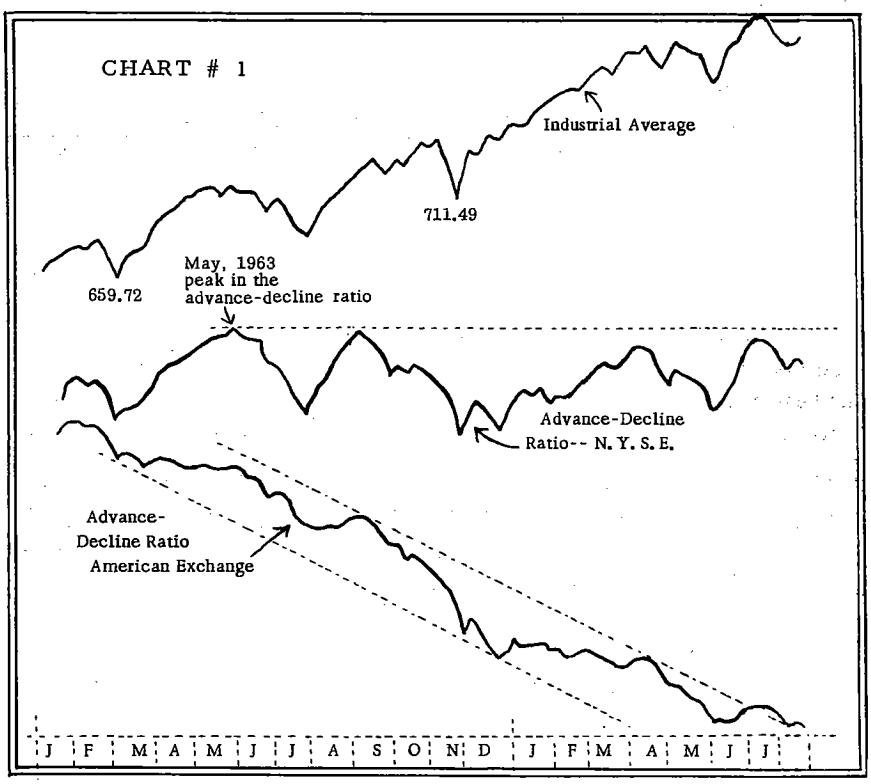
THE MARKET: The two D-J Averages recorded all-time highs on July 17, 1964, Industrials at 851.35, Rails at 220.98 (Chart 2). A decline followed and by August 6 the Industrial Average had retreated to 823.40, Rails to 211.63. In these Letters I stated that it was what occurred after the decline which would constitute the significant action.

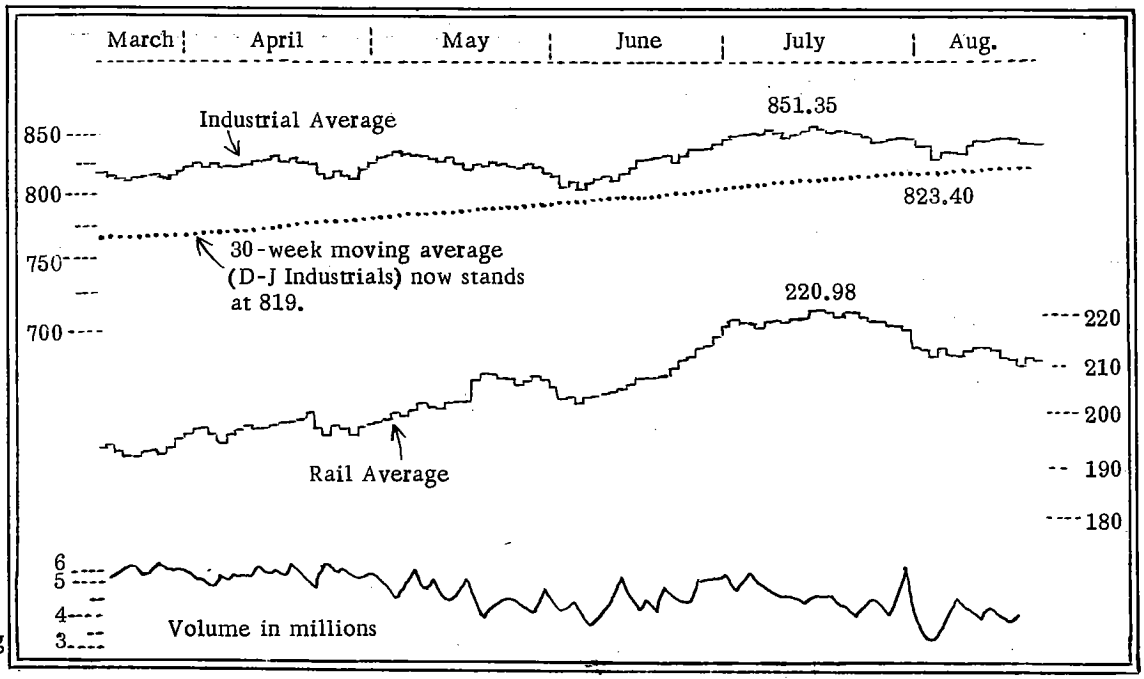
On August 7 the expected rally began. The new rally was characterized by lackluster volume, sluggish action on the part of the advance-decline ratio, and an unimpressive performance by daily new highs and lows (for instance, although the rally took Industrials within 9 points of their all-time high, daily new highs reached a rally peak of only 59 on August 13).



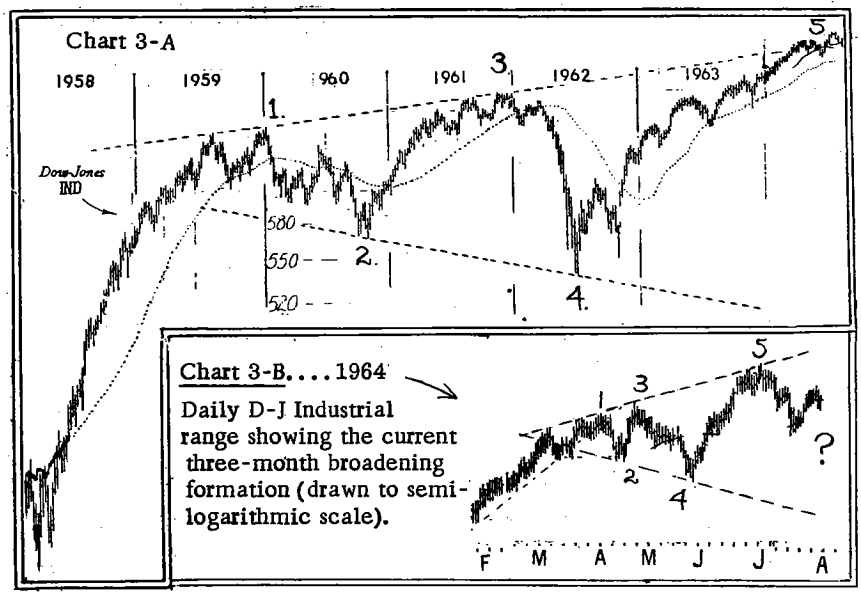
From a Dow Theory standpoint, the most significant thing about the latest rally was the refusal of the Rail Average to move out with Industrials. In fact, on August 18, the day when Industrials established their rally peak of 843.83, the Rail Average actually broke below its August low — thereby sinking to its lowest level since June, 1964. The Rail penetration of the August low serves to transfer all our attention to the Industrial Average. The question now is — will Industrials confirm the Rail weakness by violating their own August low (823.40), or will Industrials persistently refuse to confirm the Rail weakness? From the standpoint of market history, it should be remembered that many important advances have materialized from areas where one Average persistently refused to confirm a penetration of the other. Conversely, in cases where both Averages confirmed by penetrating significant bearish points (particularly on increasing volume) a new trend was almost always established.

* * * *

For the benefit of the many new subscribers I will again call attention to the remarkable long-term pattern of the Industrial Average. Note on Chart 3-A (page 2) that Industrials have traced what appears to be a gigantic "broadening formation". A broadening formation is a five-point reversal pattern, each peak occurring above the preceding



peak (points 1, 3, 5) and each low occurring below the previous low (points 2, 4). Such patterns are rare and are usually seen only in the very late stages of a bull market. They are generally distributive in nature and are the result of an extended period of frantic, "whip-sawing" often aimless speculation.



Incredibly, the giant five-year (1959 to the present) broadening formation has produced (at point 5) a smaller broadening pattern within the framework of the larger one. On chart 3-B this phenomenon can be seen quite clearly. Whether sheer coincidence or not, Industrials turned down on July 17, 1964, exactly at point 5, and it now remains to be seen whether the bearish implications of the two broadening formations will be carried out. This whole broadening concept is one which is curiously absent from almost all current market literature, although I have discussed this phenomenon repeatedly (and these Letters are read by perhaps the majority of serious analysts on Wall Street and throughout the nation).

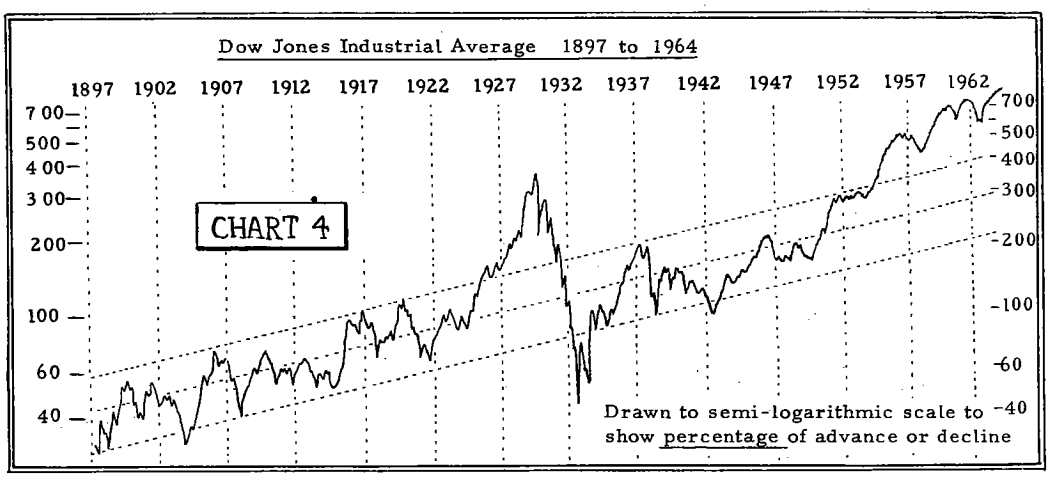
* * * *

Chart 1 (page 1) presents the current breadth picture, and here again we see a rather extraordinary situation. The advance-decline ratio on the N.Y.S.E. turned down on July 17 — in the same area from which it turned down in May, 1963, September, 1963, and April, 1964. It is this sideways movement in the mass of issues on the Big Board which has made the market such a difficult place to establish profits over the last year-and-a-half. The A-D ratio on the American Exchange has continued to follow its long bear market channel to lower levels (chart 1). Here the odds have been so heavily stacked against the stockholder that diversified positions on the junior Exchange since 1962 can only be termed "an invitation to disaster".

Conclusion: The long-term picture remains overcast, in this writer's opinion. From the immediate standpoint, the ability or inability of the Industrial Average to hold above the August low of 823.40 will spell the difference between danger or a possible new advance. Increasing volume on an Industrial penetration of 823.40 would constitute a "danger signal" well worth heeding.

SIXTY-SEVEN YEARS: In the last Letter under the section entitled "Two Schools" I discussed the current bull market, comparing it with its only "close cousin", the great bull market of 1921-29. The question was posed as to whether this bull market would end with a period of wild speculation, in the manner of the 1921-29 bull market, or whether because of the greater age of this bull market it would simply "run out of breath" and depart "like a lamb instead of a lion".

I have included below a semi-logarithmic chart of the D-J Industrial Average covering the last sixty-seven years. This chart presents a very unusual historical perspective, and it is well worth studying in detail. Note that between 1897 and 1927 the Industrial Average moved within what might be termed a long-term "inflation" or "growth channel". And although numerous bull and bear markets occurred between 1897 and the 1920's, none of these "normal" bull and bear markets saw the Industrial Average penetrate either above or below the limits of the growth channel. In 1927, however, an extraordinary event took place. In that year the Industrial Average surged above its upper trendline under the stimulus of excited speculation, an "easy money" policy on the part of the Federal Reserve and the gradual "realization" by the majority of investors that "the nation was on the threshold of a great New Era". The New Era lasted two years. The market turned down in September, 1929, and during the ensuing bear market the senior Average plunged substantially below the lower limits of the channel (see chart).



A remarkable period of adjustment followed. The 1932-37 bull market advanced the Industrial Average to the upper trendline of the channel. The 1937-38 bear market took Industrials to the lower trendline. Between 1939 and 1942 the Average touched dead center, then slowly sagged to a point just below the lower trendline again. From 1942 to 1946 another bull market brought the Average above the center of the channel, but unlike 1932-37, this bull

market did not succeed in pushing Industrials to the top of the channel again. The final adjustment seems to have taken place during the 1946-49 period. Here the Average sank slowly below the center (trendline) of the channel, volume contracted to around one million shares (daily) for weeks on end, and Wall Street wearily awaited the next impulse. It was as though the market pendulum had come to rest on dead center. The next impulse was decidedly up.

The new bull market started on June 13, 1949. By 1953 the Industrial Average had rallied to within a fraction of the upper limits of the growth channel for the first time since 1937. In 1954 the Average accomplished two things of great import: (1) it rose above the upper limits of the channel for the first time since 1927, and (2) it bettered the 1929 high of 381.17 (which had seemed "an impossible feat" only a few years before). Many veteran analysts (such as James Hughes of New York) refer to the 1954 action as the beginning of the second "New Era market."

But whereas the spectacular 1927-29 rise penetrated the upper channel limit and continued to push beyond these limits for only two years, the current bull market has taken the Industrials beyond the upper channel limits for a period of ten years.

The question might now be asked: has the growth channel which contained the Industrial Average for the first half of the Twentieth Century finally been left behind? Is the channel now antiquated — a relic like the bustle and the horse-and-buggy? Or is this second ascent by Industrials into the area above the growth channel another temporary excursion — an excursion which is fated to be treated by tomorrow's historians as another example of Wall Street's folly?

At this time, any answer is no better than an educated guess. Dow Theorists are convinced that the law of action and reaction will finally assert itself. It would therefore come as no surprise to Dow Theorists to see the Industrial Average fully correct the great bull market and ultimately plunge below the lower limits of the channel (below 220). These pessimists are fortified in their view by the following historical fact: every bear market in history has taken the Industrial Average below the peak of the preceding bull market (in the current instance, the preceding bull market peak was the 212.50 peak of 1946). On the other hand, those who firmly believe that the Government has finally triumphed in its struggle to master the business cycle will perhaps concede that things may still get a bit difficult. But they are also convinced that conditions will never again be really bad. So bad, for instance, that the Industrial Average is pushed back within the "old growth channel". It is an interesting picture. And the final answer will undoubtedly constitute one of the most important actions of the 1960's.

DEBITS AND CREDITS: Debits (total margin accounts on the N.Y.S.E.) dropped to $5.289 billions in August while credit balances (cash in customers' accounts) slipped to $1.114 billions in August. Dr. Sloan Wilson of Kansas (the leading expert on these figures) wrote me on August 18 and parts of his very informative letter are included below:

"My broker just called me after the close, and gave me the figures for the Credit and Debit Balances for the month of August. They just do not look good to me at all.

"Both the Credit and Debit Balances decreased for the month of August. The trend of the Debit Balances now seems to be definite and they have been in a decline since their peak last November. Thus the speculator is gradually getting out of the market, definitely not a bullish sign.

"The Credit Balance figures are also declining and are at their lowest point since last August. Again, this has not been a drastic decline. But it indicates that the public is not entering the market with any speculative ideas in mind; they are not taking the stocks off the hands of the professionals.

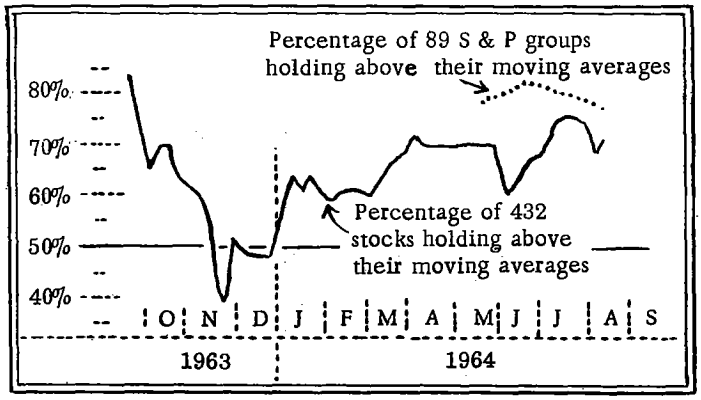
"As you and I have tried to tell those who would listen, the first advance after a crash of the 1962 proportions makes the public very leary of the first bull market advance. This is certainly true at present, and there are indications that the public just will not enter this market with any noticeable participation.

"To me it seems that too many analysts are expecting the DJIA to go into the nine-hundreds with a final speculative phase. This may be the real fooler of this market, but I personally doubt that it will happen."

NOTE: In Letter 260 I wrote a detailed account of the potential monetary crisis which is brewing in London. I also discussed the serious repercussions which such a crisis could exert on our markets. I was therefore interested to note that Mr. Alden Wells (a leading monetary expert) has now started a Monetary Report dealing with the critically important world money situation. Mr. Well's August, 1964 (I believe it is his first) report is fascinating. He feels that a sterling crisis may occur in London before the October election; he further believes that "the weakness of the English pound has been the chief sustaining factor of the dollar." Mr. Wells is of the opinion that coming money troubles could result in raising "long-term interest rates to levels not seen in our generation." The Wells report is being handled by my friends at Indicator Digest, Palisades Park, New Jersey. If you are interested in this vital subject I suggest that you write them for further information.

STOCKS: Of 432 representative stocks which are tabulated here weekly, 310 (71%) are now holding above their long-term (200-day) moving average (M.A.). This is no change from last week (see chart on page 4). The study remains bullish as long as the percentage is above 50%. With this Letter I am also adding (same chart) the bullish percentage "count" of 89 Standard & Poor groups. This should provide another valuable confirmatory measurement of market breadth. The percentage of groups

now above their 200-day M. A. is 77% (this tabulation is taken from the valuable Indicator Chart Service, Palisades Park, New Jersey).

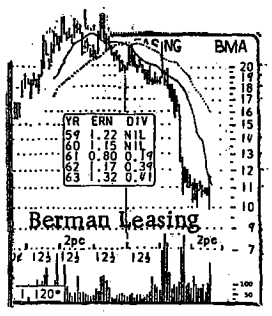

Percentage of 89 S & P groups holding above their moving averages
Percentage of 432 stocks holding above their moving averages
80%
70%
60%
50%
40%
O N D J F M A M J J A S
1963
1964

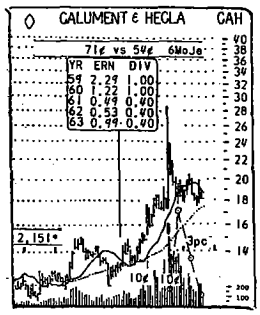
QUESTION: "Aside from the fact that it is generally bullish if a stock holds above its 200-day moving average (M. A.) and bearish if it remains under its M. A., what other uses can be made of the M. A.?" (R. Springer, Bangor, Maine).

ANSWER: I have found that the 200-day or long-term M. A. can also be an excellent guide for measuring market "over-enthusiasm" or "over-pessimism" in individual stocks. In fact, I use what I term "the 30% rule" in connection with the 200-day M. A. (Note: the 200-day M. A. appears as a dotted line on the accompanying weekly charts, while the shorter 10-week M. A. appears as the solid line).

Whenever buying or selling carries a stock approximately 30% or more above or below its 200-day M. A., the odds are that the stock is overdue for a correction —a correction which will in all likelihood take the stock back to the vicinity of its M. A. again. This phenomenon can best be illustrated with a few actual examples.

Note that Calumet & Hecla (under the influence of recent buying hysteria) rose almost 50% above its 200-day M. A. The stock subsequently tumbled and is now near its M. A. again. Those who bought CAH in the high 20's have seem almost half their investment melt away. The application of the 30% rule near the highs would obviously have saved enthusiastic buyers much agony.

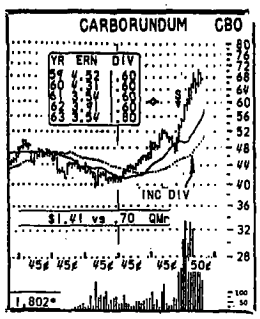


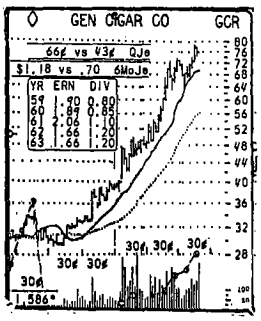


Conversely, Berman leasing recently collapsed, plunging almost 50% under its M. A. The stock is probably now in the process of building a base which will serve to take it back at least to its M. A. again.

In guaging the correction back to the 200-day M. A., it should be remembered that during a major bull swing, a stock will tend to hold (on all rallies and declines) above its 200-day M. A. (the converse is true during a major bear swing). A definitive push through the 200-day M. A. often signifies a major reversal in a stock's trend (rather than a corrective movement).

Two stocks which have currently advanced into the "danger area" of better than 30% above their M. A.'s are Carborundum and General Cigar. Because of this (and I use these as mere examples) they are overdue for a correction which will probably bring them back to their vicinity of their M. A. lines again.





Conclusion: No matter how enthusiastic one becomes regarding a stock, do not buy it if it is too far from its M. A. If you do, you run the strong risk of being caught in a technical correction, even though the stock may remain strongly bullish.

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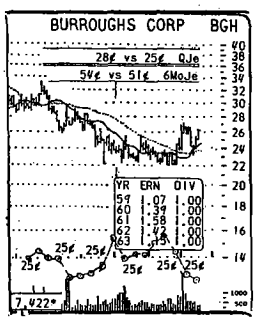
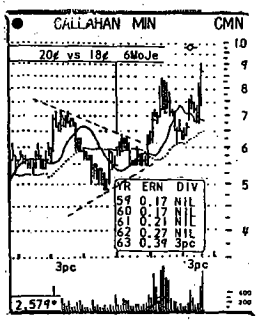
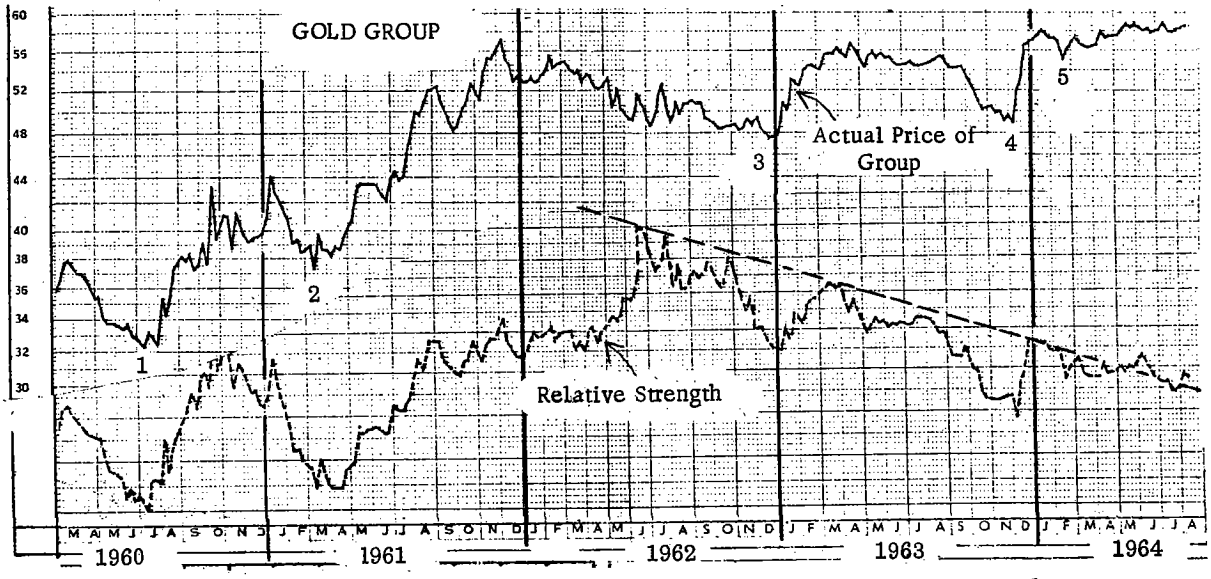
The long-term or 200-day M. A. can serve another useful purpose— it can represent a "last line of defence." I list two examples as follows: Burroughs was recommended in Letter 257 and again in more recent Letters. The stock broke out of a long base, held in the 26-27 area for three weeks (see small weekly chart), then broke to the 23 1/2-25 area. But note that BGH tended to hold at or above its 200-day M. A. The breakdown from the recent little four week "line" might have frightened the average technician (not without cause), but he was, nevertheless, entitled to hold BGH until it broke below its 200-day M. A. Note that the M. A. (solid line) has now climbed above the 200-day M. A., and that the 200-day M. A. is now in an upward trend. Bulls on BGH can now note this is the first time in many many months that BGH is above its two M. A.'s while the two M. A.'s are also in rising trends. Moral: Over the past month only the 200-day M. A. kept technicians from "throwing in the sponge" on BGH. Conclusion: Hold BGH as long as it can stay above its 200-day M. A. which now stands at 23 3/4.

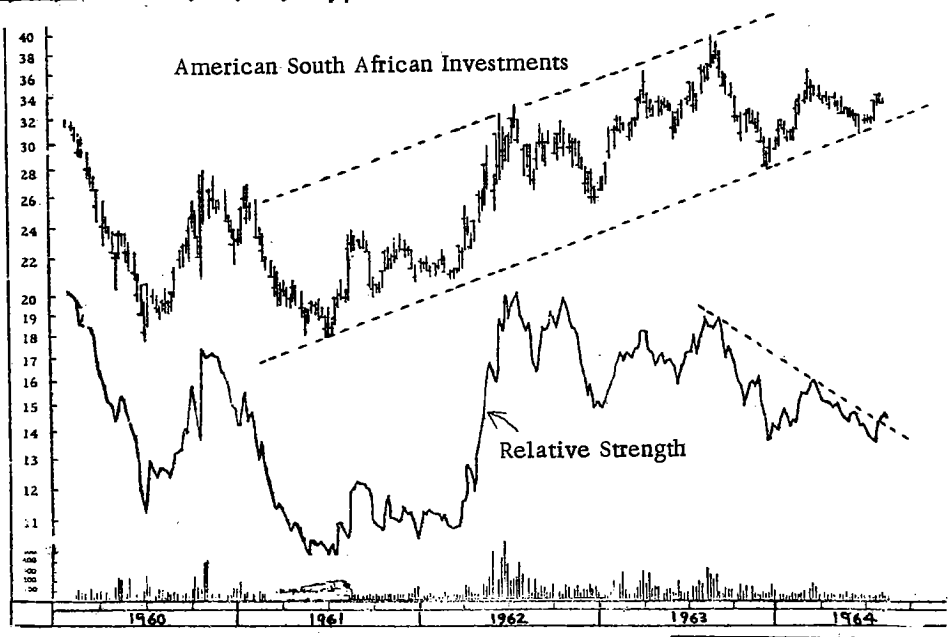


Callahan Mining was recommended in Letter 248 at 6 1/4. Note that following the breakout from the symmetrical triangle, CMN rallied to 8 1/2, then fell back to exactly its 200-day M. A. (having actually broken below its 10-week M. A.). However, two factors said "hold": (1) The stock did not violate its long-term M. A. (2) The stock held above a trend-line connecting its recent lows. This week CMN pushed above all highs of the past few years. Conclusion: Hold CMN as long as it remains above its 200-day M. A. which is now climbing rapidly.

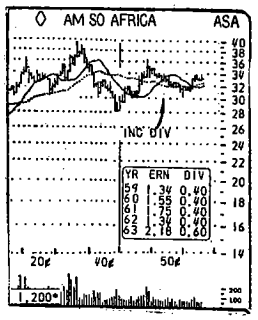


GOLD: Few people are aware of the long term picture in the Gold stocks. I have included a chart of the Gold Group from 1960 to the present. Note that during each year since 1960, the low point for the Gold Group has been above the preceding year. These five ascending bottoms are numbered 1 through 5 on the chart. The price of the Gold Group is now "flattening out" just above the vicinity of the 1961 high. The rising bottoms since 1960 strongly suggest accumulation. Probabilities suggest that the next movement in the golds will be up. These probabilities are further heightened by the fact that the relative market action or relative strength of the Gold Group is now pushing away from a declining trend-line (see chart) which has been in effect since mid-1962. We will watch the action of the Gold Group with particular care from here on. A dramatic story may be ready to unfold.





American South African is a closed-end investment company which holds S. African gold stocks. This stock (traded on the N. Y. S. E.) has been rising within its channel since 1961. Lately it has shown signs of wanting to reverse its relative strength line (see chart) to the upside. I believe this stock is a "buy" at the market. Safety valve: Sell it if it breaks below 30 which would break the channel, and also break its 200-day moving average (see small chart). If the stock pushes above its 1964 peak (if it hits 37) double up on your commitment.



A second gold which is no stranger to readers of these Letters is Dome Mines. Like American South African, Dome has been climbing along a rising channel since 1960. Dome looks powerful, and I see nothing wrong with a commitment of this stock in every account. The 200-day M.A. on Dome (see chart) now stands at 27. The stock should have support there and further strong support at the 25 level.

LATE NOTE: (10 A.M. Tuesday, August 25). This writer, being not much of a sleeper, spent last night from 3 A.M. to 7 P.M. in a hot bathtub going over the charts of every stock on the N.Y.S.E. and the Amex. Final 7 P.M. personal opinion: the great majority of stocks appear to be under distribution. The good-looking stocks are few and far between. I would guess that this market's going a good bit lower before it goes a good bit higher. Suggestions: Sell Pan Am. Airlines, Western Airlines, RCA, MMM short at the market. Sell Pan Am. Sulphur short if it touches 30.

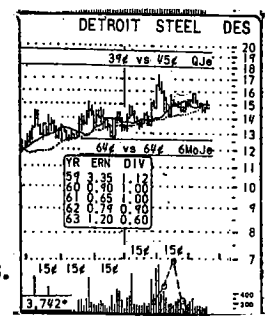


Chart 3-A, 3-B, all small weekly charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas. Large charts of Gold Group, Dome, courtesy of Traders Research, 1431 Pearl Avenue, Alton, Illinois 62003.